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No. 527.

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1924.

APPEAL FROM THE COURT OF CLAIMS.

THE UNITED STATES, Appellant,

vs.

HARRIET ROGERS FLANNERY and J. ROGERS FLANNERY, Executors of the Estate of JAMES J. FLANNERY, Deceased.

PETITION FOR A REHEARING.

TO THE HONORABLE THE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Harriet Rogers Flannery and J. Rogers Flannery, Executors of the Estate of James J. Flannery, Deceased, your petitioners, respectfully submit that they have been aggrieved by the opinion of the Honorable Justices of this Court rendered herein on the 13th day of April, 1925,

in the respects herein set forth, and pray for a rehearing of said matter.

1. The opinion errs in holding that your petitioners' decedent sustained no actual loss in the transaction in question because said decedent sold his stock for more than the original cost thereof; and

2. In holding that the Court's decision reached in this case is controlled and required by the decisions of this Court in

Goodrich *v.* Edwards, 255 U. S. 527, and
Walsh *v.* Brewster, 255 U. S. 536.

POINT 1.

Accumulations prior to March 1, 1913, are capital. Under our system of law it is the property itself and not the original cost of it to which the owner is entitled. A capital accumulation in property prior to March 1, 1913, even though not resulting from money expenditure, is a property right and a subsequent sale at a price less than original cost plus subsequent accumulations prior to March 1, 1913, is an actual loss.

POINT 2.

The rule adopted in Goodrich *v.* Edwards, *supra,* and Walsh *v.* Brewster, *supra,* require that the loss resulting from the subsequent sale of property acquired prior to March 1, 1913, should be on the basis of cost or market, whichever is higher, and not on the basis of cost or market, whichever is lower. The Revenue Act of 1924 has adopted the correct basis. The interests of the taxpayer require this construction, which results in no appreciable loss to the Treasury.

POINT 1. Accumulations prior to March 1, 1913, are capital. Under our system of law it is the property itself and not the original cost of it to which the owner is entitled. A capital accumulation in property prior to March 1, 1913, even though not resulting from money expenditure, is a property right and a subsequent sale at a price less than original cost plus subsequent accumulations prior to March 1, 1913, is an actual loss.

All accumulations of income, including the increment due to appreciation in value of the assets of the taxpayer prior to March 1, 1913, are capital for the purposes of the Federal Revenue Laws.

> Southern Pacific Company *v.* Lowe, 247 U. S. 330.

where the court disposes of this question in these words:

> "This being so, we are bound to consider accumulations that accrued to a corporation prior to January 1, 1913, as being capital, not income, for the purposes of the act. And we perceive no adequate ground for a distinction in this regard, between an accumulation of surplus earnings, and the increment due to an appreciation in value of the assets of the taxpayer."

This court has always held that it is the property itself and not the original cost of it to which the owner is entitled.

> Minnesota Rate Cases, 230 U. S. 350,

where the court, at page 454, declared the principle in these words:

> "It is clear that in ascertaining the present value we are not limited to the consideration of the amount of the actual investment. If that has been reckless

> or improvident, losses may be sustained which the community does not underwrite. As the company may not be protected in its actual investment, if the value of its property be plainly less, so the making of a just return for the use of the property involves the recognition of its fair value if it be more than its cost. The property is held in private ownership, and it is that property, and not the original cost of it, of which the owner may not be deprived without due process of law."

To be sure, this was a confiscation case, but it is difficult to distinguish between property rights which may be taken in the form of rate regulation and property rights which may be appropriated under a rate of taxation which in 1918 amounted to 12% normal tax and up to 65% surtax, and which in 1919, the year in question, amounted to a normal tax of 8% and a surtax up to 65%. This principle that it is the present value of the property and not the original cost thereof to which the owner is entitled is settled by this court in an unbroken line of confiscation and condemnation cases, and in the Minnesota Rate Cases just cited is regarded as so thoroughly established as not to require the citation of authorities.

Our income tax laws might have been drawn on the theory that capital gains should not be considered as a part of gross income subject to taxes, but it is well known that Congress has adopted a different policy and included capital gains in gross income subject to income taxes. The rate of tax upon capital gains was the same as the rate upon other income, until the enactment of the Revenue Act of 1921, which established a maximum 12½% rate where the property had been held in excess of two years. Just as capital gains were included in gross income, so capital losses were allowed as a deduction from gross income in determining net taxable income, and this practice is uniform throughout all our revenue laws beginning with the Revenue Act of 1913, except that the

Revenue Act of 1913 limited deductions for losses to those incurred in trade or arising from fires, storms, or shipwreck, and not compensated for by insurance or otherwise. The Revenue Act of 1916 extended the provisions for deductions for losses to include losses in transactions entered into for profit but not connected with trade or business up to the amount of the profits arising therefrom. Finally, in the Revenue Act of 1918, the basis of determining gain or loss sustained from the sale or other disposition of property are made identical and are provided for in the same words (see Section 202, Revenue Act of 1918).

Under the interpretation of this section 202 of the Revenue Act of 1918 adopted in the opinion in this case, the deduction for losses is confined to the difference between the original cost or market value on March 1, 1913, whichever is lower, and the selling price.

If the property were seized in condemnation proceedings on March 1, 1913, it is the present value of the property and not the original cost of it to which the owner would be entitled. If the property, on March 1, 1913, had been sold at its then market value to a purchaser who in 1919 sold the same property at a loss, the purchaser would be entitled to deduct such loss in computing net taxable income of the year in question. If, however, the original purchaser of the property does not sell on March 1, 1913, but continues to hold the property and himself takes a loss in the year in question, then the loss (above the original cost) is denied to the holder.

As it is the present value of the property itself and not the original cost of the property to which the owner is entitled under our system of law, it is difficult to understand the basis for allowing a full deduction to a purchaser from an owner on March 1, 1913, at the then market value, but to deny a deduction to such owner

who himself continued to hold the same property and later sold it for less than such value, even though above original cost.

Doubtless the view of the court was influenced by the fact that the market value of stock fluctuates irrespective of the intrinsic value of the stock, but it is also a well-known fact that in many cases the appreciation in market value of stocks is due to an accumulation of corporate surplus. Appreciation in price of securities may be due to the external conditions of an improved market, or may be due to an enhancement in intrinsic worth resulting from the accumulation of surpluses which might have been paid in dividends. It seems unfair as between taxpayers to allow a stockholder in the corporation which has made a practice of distributing all of its surplus in dividends from the date of original purchase prior to March 1, 1913, down to that date to get the benefit of all such dividends without income taxation, and on subsequent sale to tax a stockholder upon such surpluses in the corporation which has allowed its surpluses to accumulate over the same period. If the enhancement in market value of the security prior to March 1, 1913, above the original cost due to the accumulation of such surplus is to be ignored in determining the deductible loss upon sale, the substance of the transaction is a capital tax, not an income tax. To be sure, we are dealing with deductions and it is for Congress to say to what extent deductions from gross income should be allowed in determining net taxable income. The law purports to allow a deduction for capital losses, and this court has decided that accumulations prior to March 1, 1913, are capital and not income.

When consideration is given to the cases which arise with regard to property other than securities, it at once bceomes apparent that a taxpayer may suffer an actual

and severe loss even though the price realized may be above original cost. Some of the instances are as follows:

(*a*) A copartnership begins business 50 years prior to March 1, 1913, and through industry, skill, integrity, close attention to business and a long and unbroken course of fair dealing, builds up a good will of admitted great value on March 1, 1913. Such firm is engaged in a world-wide mercantile business which during the world war and the reconstruction period following the war is practically wiped out and sells its entire business with little or no allowance for good will. The good will may have had an actual value of $1,000,000 on March 1, 1913, but the firm is unable to prove any actual original cost thereof in money. To be sure a half dozen lives may have been devoted to the service and effort which built up this good will, but there is no actual cash outlay. Can it be said that a firm which in 1919 sells its good will, built up through 50 years of effort and which on March 1, 1913, could have been readily sold for $1,000,000 or more, suffers no actual loss by the disposal of such good will for a nominal amount in 1919 or 1920?

(*b*) A manufacturing corporation is formed by consolidations of other existing companies late in the last century and in that connection takes over from them very large holdings of timber lands at a small original cost. The timber continues to grow and on March 1, 1913, is of great value. Subsequently, in 1918 to 1920, the spruce bud-worm ravages the forest and destroys millions of dollars worth of spruce trees valuable for pulp wood or lumber. Is the loss for income tax purposes to be measured by the original cost of a half century ago and without allowing for the increase in value due to growth as well as the appreciation in price?

(*c*) A man personally plants an orchard 40 years ago and spends all his intervening time in tending and

caring for the orchard, until on March 1, 1913, such orchard is in its prime. If the orchard should be destroyed by a cyclone in 1918, 1919 or 1920, can it be said that the owner has suffered no loss merely because he has no cash outlay? In this latter case, assuming that the owner had devoted all of his time to the orchard, he would be able to prove the value of the labor that had gone into the orchard. This, however, would be but a small portion of the actual expenditure, for the thing that makes success is the skill, care and devoted attention which cannot be measured in money. One man spent a lifetime with nothing to show for it at the end. Another, under apparently similar external circumstances, but with a different character, makes a great success. Who is qualified to measure in money the added value of the successful labor over that of the man who failed?

Under the rule adopted by the court, the taxpayer will be denied all deduction for losses upon the sale of property acquired prior to March 1, 1913, unless the taxpayer is in a position to prove the original cost of the investment. During the period prior to the revenue laws it was well known that accounting had not reached its present state of exactness and many records which were sufficient for the purpose of ordinary business operations were wholly defective in disclosing the original cost of capital assets.

POINT 2. The rule adopted in Goodrich *v.* Edwards, *supra,* and Walsh *v.* Brewster, *supra,* requires that the loss resulting from the subsequent sale of property acquired prior to March 1, 1913, should be on the basis of cost or market, whichever is higher, and not on the basis of cost or market, whichever is lower. The Revenue Act of 1924 has adopted the correct basis. The interests of the taxpayer require this construction, which results in no appreciable loss to the Treasury.

The cases of Goodrich *v.* Edwards, *supra,* and Walsh *v.* Brewster, *supra,* do not require the denial of a deduction based on the market value on March 1, 1913, when above original cost. Those two cases were decided to relieve a taxpayer from tax where the sale price was below the actual investment. It was a generous and proper interpretation of the statute not to reflect a heavy tax where in fact there was no gain on the basis of the outlay; but it does not follow that another taxpayer should be subjected to equally heavy taxes without allowing for a loss based upon the value of the property at the time the Sixteenth Amendment was enacted and the first income tax law thereunder became effective. There is just as much equity in allowing a loser a deduction based upon the original cost or the value on March 1, 1913, whichever is higher, as there is in determining the gains on this basis, and the wisdom of this course is indicated by the action of Congress on the recommendation of the Treasury Department in embodying such provision in the Revenue Act of 1924, after three years experience under the Revenue Act of 1921 in limiting the deduction to original cost or market value on March 1, 1913, whichever is lower. There is no case of greater hardship upon the taxpayer than to impose the very heavy normal and

surtax rates in effect in 1918 and 1919 without allowing a deduction for losses based upon capital values as of March 1, 1913, when the Sixteenth Amendment took effect, and these cases of great individual hardship can be avoided without appreciable loss to the Treasury. Congress recognized all this in enacting the Revenue Act of 1924, for the report of the Ways and Means Committee, in reporting that Act back to the House with the recommendation that it pass, contained a provision which referred to the section in question in these words:

> "(8) Subdivision (*b*) provides that the basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be the cost of the property or its fair market value as of March 1, 1913, whichever is higher. This provision changes the existing law in the interests of the taxpayer. It simplifies exceedingly the rule in effect under the present law without appreciable loss to the Treasury." (Report of Ways and Means Committee, p. 18.)

Conclusion.

Section 202 of the Revenue Act of 1918 provides the basis for the determination of gain or loss in identical words. The cases of Goodrich *v.* Edwards, *supra,* and Walsh *v.* Brewster, *supra,* require an identical and not a correlative interpretation. The interests of the taxpayer, so fully protected by the court in those cases, require that the burdensome tax rates in effect in 1918 and 1919 shall not be imposed without allowing a deduction for losses on the basis of capital values existing on March 1, 1913, even though above original cost, and this can be done without appreciable loss to the Treasury, as Congress and the Treasury have ascertained after a test of the other rule in the Revenue Act of 1921.

WHEREFORE, petitioner respectfully urges that a rehearing may be granted and that the mandate of this court may be stayed pending the disposition of this petition.

Dated: New York, N. Y., May 15, 1925.

HARRIET ROGERS FLANNERY and
J. ROGERS FLANNERY, Executors of the Estate of JAMES J. FLANNERY, Deceased.

By
SANFORD ROBINSON,
Attorney for Respondent.

I, SANFORD ROBINSON, of New York, N. Y., an attorney regularly admitted to practice in the Supreme Court of the United States, do certify that in my opinion the foregoing petition for rehearing in the case of The United States, Appellant, *v.* Harriet Rogers Flannery and J. Rogers Flannery, Executors of the Estate of James J. Flannery, Deceased, No. 527, is well founded and that it is presented in good faith and not for the purpose of creating a delay.

SANFORD ROBINSON

Supreme Court of the United States.

OCTOBER TERM, 1924.

No. C 1080.

THE UNITED STATES OF AMERICA,
APPELLANT,
v.
HARRIET R. FLANNERY,
RESPONDENT.

Brief Submitted by Richard W. Hale and Reginald H. Smith, Amici Curiae.

INTRODUCTION.

This brief is filed for the purpose of commenting upon certain aspects of the case of—

Goodrich v. *Edwards*, 255 U.S. 527 (1921).

If the case now at bar is to be considered *de novo*, that is one thing. In that event the contentions upon either side must stand or fall because of their inherent soundness, and not because *Goodrich* v. *Edwards* rules as a precedent. On the other hand, if this case is to be considered from the point of view of putting *Goodrich* v. *Edwards* into one pan of the scales of justice as a thing of weight—why then there is occasion to

weigh it carefully, and upon that matter we attempt to make a contribution.

ARGUMENT.

The sum and substance of what we have to say is that the extraordinary complications of our present generation strike at the root of our system of reliance upon precedents. Times are changing in the law, and in the present time a precedent is a valuable thing only when it results from a controversy wholly and fairly fought out. The adversaries must have been properly matched and fairly confronted. They must have desired to win, and they must have been well armed and equipped to that end.

Goodrich v. *Edwards* is quite the reverse of all this. The Goodrich case was one between the government and a single taxpayer. The taxpayer was not a fair representative of the whole body of interested persons opposed to the government. It is probable that the government wanted him to win *in the way he did* as badly as he wanted to win, no matter what way. At any rate there was a large body of interested persons whom the government did defeat by that decision, if the construction given it by the taxing authorities is correct. It is probable that there was a distinct intention and hope to defeat this particular class of persons in their absence, and without a hearing. Their first appearance before this Court is in this and the parallel cases now pending here. Under such circumstances they ought not to be prejudiced by the previous decision.

If we were dealing with an isolated case, there might be some argument in favor of standing by the old

customs for convenience and general advantage. The power to rely upon precedents is a valuable one, and high authority for precedent is a thing which has many advantages. But this is not an isolated case. Far from being sporadic or unusual, the trouble is almost epidemic, and there is a general situation which should be faced.

We purpose to illustrate and describe this situation by stating a number of actual or reasonably imagined analogous cases.

Take, first, cases in which a will is construed and other like equity suits. In these it is trite that the Court will insist on hearing argument from all classes in interest.

On the other hand, illustrating the same point, take the declaratory opinions such as those that are given by the justices of the Supreme Judicial Court of Massachusetts "upon important questions of law and upon solemn occasions." There is an outstanding warning that these opinions are substantially not binding as precedents for lack of argument in behalf of those interested.

> "These opinions, as has been decided repeatedly, are purely advisory, are given without the benefit of argument, and are formed and expressed under such circumstances that they cannot be considered as binding authorities and are open to reconsideration and revision. They, however, presuppose 'that the subject to which' they relate has 'been judicially examined and considered.' The justices, when called upon, sitting as a court, to deal with such questions again, regard it as their 'duty

> most sedulously to guard against any influence which might flow from . . . previous consideration' of the same questions in their advisory capacity."
>
> *Perkins* v. *Westwood,* 226 Mass. 268, at 271 (1917).

Next take the story which we hang, as upon a peg, to the case of *United States* v. *Phellis,* 257 U.S. 156 (1921), although we do not suggest that it is the story of that case.

In the years 1913-1916 there were many reorganizations and consolidations. Afterwards the lawyers concerned realized that the exchanges made in some of these reorganizations registered a profit, brought about taxation of it and also started a new basis for fixing the profit upon a future sale. The matter usually comes up in a test case where a taxpayer appears to be resisting the tax on the exchange. But suppose a rich shareholder in the very Phellis case corporation had desired to sell his shares in 1918. If he had established a new basis of cost by the previous reorganization, he could afford to sell. If he had not done so, the tax on his profit would crush him. By the time the Phellis case was argued here anyone who had sold in 1918 must have been passionately desirous to see the government win the case and assess him for a 1915 tax.

We submit that it would be desirable and practicable for this Court to insist that such cases as the Phellis case should not be argued until the Court had before it briefs for the shareholders whose interest it was to lose the case, and for those whose interest was on the

contrary to win, and also until the Court knew which was which.

Next take the income-tax situation under the direct-tax clauses of the Constitution. The issue is clearly defined. On the one side, population; on the other side, constitutional foresight safeguarding the wealthier communities. In the Pollock arguments both sides were well represented, but in—

Springer v. *United States*, 102 U.S. 586 (1881)—

a Civil War income-tax case, the contestant who lost, with his professional income, was obviously not a fair representative of the property interests which the Constitution had sought to safeguard against mere population.

In the foregoing illustrations we have put before the Court a sufficient collection of instances. From them we may extract a principle that *stare decisis* does not apply when a question has been settled without full argument and without hearing both sides.

It remains to examine the question whether *Goodrich* v. *Edwards* is a case where this principle should be applied.

Who were the parties truly interested in the construction of the statute?

Goodrich and his ilk wanted to contend that he should not be taxed upon a gain when the amendment to the Constitution on March 1, 1913, found him owning securities which had sunk in value and the tax gatherer had figured the gain from that low point. If he could get rid of that tax, he cared not how.

The statute as it had been construed by regulations

did justice to men with losses, like Mr. Flannery. In 1913 his wealth was a question of fact. He was just as rich as he was in substance and he was made no richer by the circumstance that something had cost him more than it was then worth. He had property and it had value, but the incident that some of that property had been bought dear in the remote past was a trifle of little or no substantial importance. He was profoundly interested to contend that that trifle should not result in a heavy tax upon him. Accordingly Flannery sold the property at a substantial loss compared with its 1913 value. And he had been told by the tax gatherers in their regulations what the effect of that sale would be.

Goodrich and Flannery are really the contestants upon opposite sides of this controversy. It is true that the government stood to lose a lot of taxes on gains and to gain a lot of tax money by cutting down deductions for losses. The Department of Justice should have decided (and probably did decide) that there were more losses than gains to be affected by a decision in the Goodrich case. At any rate it allied itself with Goodrich in the sense that it endeavored to have him win upon a basis which would make the absent Flannery lose. But who warned Flannery?

If the Court will examine the record and briefs in the Goodrich case, it can satisfy itself that both were truly inadequate to a presentation of Flannery's contentions.

The important and almost crucial contention based on the regulations and practice of the Treasury was not open upon that record. But see—

National Lead Company v. *United States*,
252 U.S. 140, at 146 (1920)—

to the effect that that contention is ordinarily conclusive in favor of such men as Flannery.

The brief for Goodrich does not argue the case along statutory lines. The brief by the Solicitor General yields victory to Goodrich and then argues the statutory point. Goodrich files a reply brief and naturally does not even mention this or any of the weaknesses of a situation which is going to make Goodrich win.

CONCLUSION.

This is no sort of a case in which to apply the rule of *stare decisis*.

Richard W. Hale
RICHARD W. HALE.

Reginald H. Smith
REGINALD H. SMITH.

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IN THE

Supreme Court of the United States,

OCTOBER TERM, 1924.

UNITED STATES, Appellant, vs. HARRIET ROGERS FLANNERY, and J. ROGERS FLANNERY, executors of the estate of James J. Flannery, deceased.	No. 527.

BRIEF BY SANFORD ROBINSON, OFFICE AND POST OFFICE ADDRESS, NO. 26 LIBERTY STREET, NEW YORK, N. Y., AMICUS CURIAE.

Statement of Facts.

The respondents are the executors of the Estate of James J. Flannery, a taxpayer, now dead, who in 1919 sold certain shares of stock at a price which was less than the fair market value of said stock on March 1, 1913 but in excess of the actual original cost to him prior to March 1, 1913 of such shares. After the taxpayer died a return of net income subject to taxes under the Revenue Act of 1918 for the year 1919 was filed by his executors, in which a deduction was taken for a loss represent-

ing the difference between fair market value on March 1, 1913 and sales price in 1919 of such shares, but this deduction was disallowed by the Commissioner of Internal Revenue and an additional assessment based upon such disallowance was paid by the respondents who now seek to recover the amount of such additional assessment with interest.

Argument.

This case presents the question whether under the Revenue Act of 1918 a loss sustained from the sale of property acquired before March 1, 1913 shall be allowed as a deduction in computing net income for 1919 where such loss, within the terms of the statute, is the difference between the fair market value on March 1, 1913 of property acquired prior thereto and sales price thereof in 1919, and is incurred in trade or business or in a transaction entered into for profit when not connected with trade or business, although the sales price is in excess of the original cost of such property to the taxpayer. The provisions of the Revenue Act of 1918 effective for the year 1919, dealing with the basis of ascertaining gain or loss as applied to the deductions which are the subject of this suit, are clear and explicit in these words:

> "Section 214. (*a*) That in computing net income there shall be allowed as deductions:
>
> (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;
>
> (5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *"

> "Section 202. (*a*) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> (1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and
>
> (2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with Section 203."

The Revenue Act of 1918, like prior Federal Revenue laws, adopted the March 1, 1913 value as the basis for determining gains realized or losses sustained from the sale or other disposition of property acquired before March 1, 1913. The Revenue Act of 1918 was construed by the Treasury Department in Regulations 45, and Sections 214 and 202, *supra,* were interpreted in these words:

> "Article 1561. * * * For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is (*a*) its fair market price or value as of March 1, 1913, if acquired prior thereto, or (*b*), if acquired on or after that date, its cost or its approved inventory value. * * * ".

No question as to the meaning of the quoted sections of the statute was raised until the case of

> Goodrich *vs.* Edwards, 255 U. S. 527, decided March 28, 1921,

held in dealing with the question of gains that there was no taxable income unless the price realized was in excess of the original cost as well as in excess of the fair market value on March 1, 1913, upon the ground that there could be no income subject to

tax unless there was an actual profit. The Department of Justice concurred in this, and abandoned its former position in support of the tax in question in that case.

The Solicitor General stated in his brief for the Government in that case that the Treasury Department's construction of the Revenue Act of 1916 presented a "serious constitutional question". The court's decision is based on the construction of the statute and not on constitutional grounds. However, a court will construe a statute to avoid any question of constitutional limitations, where this is possible, and the court undoubtedly gave consideration to the Solicitor General's constitutional doubts.

There is no such constitutional question involved in the statutory provisions relating to allowable deductions in determining taxable net income, which is wholly a matter of the plain meaning of the statute, having in mind the familiar and established rule that a tax statute should be construed most strongly against the Government.

After Goodrich *vs.* Edwards, *supra,* was decided, Article 1561 of Regulations 45 was amended on July 28, 1921, by Treasury Decision 3206 to read in these words:

> "Article 1561. *Basis for determining gain or loss from sale.*—For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is the cost of such property, or if acquired on or after March 1, 1913, its cost or its approved inventory value. But in the case of property acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, the gain which is taxable is the excess of the amount realized therefor over such fair market value. Also in the case of property acquired before March 1,

> 1913, when its fair market value as of that date is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor. No gain or loss is recognized in the case of property sold or exchanged (*a*) at more than cost but at less than its fair market value as of March 1, 1913, or (*b*) at less than cost but at more than its fair market value as of March 1, 1913. * * *"

This amendment of Article 1561 is an attempt to shift to a taxpayer who sustains losses taxes which the Government may have lost by virtue of the decision in Goodrich *vs.* Edwards, *supra*, from taxpayers who had realized untaxed gains. There is no language in this decision which requires losses resulting from the sale of property acquired prior to March 1, 1913, to be determined on the basis of original cost or the value on March 1, 1913, whichever is lower. The question of statutory losses or the determination thereof was not before the court in this case. In fact Article 1561, as amended by Treasury Decision 3206, *supra*, seems contrary to the converse of that opinion, because it cuts off as an allowable deduction a loss where property is disposed of at a price greater than March 1, 1913 fair market value but less than original cost. The amendment to Article 1561 of Regulations 45 relative to the Revenue Act of 1918 is not based upon a construction of the statute but is based upon expediency in an attempt to retrieve from losers the taxes from which taxpayers realizing gains were relieved under the Goodrich *vs.* Edwards decision. These provisions of Article 1561 as amended were carried into the Revenue Act of 1921 in these words:

> "Sec. 202. (*a*) That the basis for ascertaining the gain derived or loss sustained from a sale

or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; * * *

(*b*) The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by sub-division (*a*); but—

(1) If its fair market price or value as of March 1, 1913, is in excess of such basis, the gain to be included in the gross income shall be the excess of the amount realized therefor over such fair market price or value;

(2) If its fair market price or value as of March 1, 1913, is lower than such basis, the deductible loss is the excess of the fair market price or value as of March 1, 1913, over the amount realized therefor; and

(3) If the amount realized therefor is more than such basis but not more than its fair market price or value as of March 1, 1913, or less than such basis but not less than such fair market price or value, no gain shall be included in and no loss deducted from the gross income. * * *"

When the Revenue Act of 1924 was enacted, the Revenue Act of 1921 had been effective for three years and the Treasury Department had had three years experience in its administration. The Revenue Act of 1924 makes important modifications in the provisions relating to the basis for determining gain or loss. It reenacts the rule adopted in Goodrich *vs.* Edwards, *supra,* relating to gains; but it rejects the rule for determining losses which was first announced in the Treasury Decision amending Article 1561, *supra,* and afterward carried into the Revenue Act of 1921, and in lieu thereof provides

that in the case of losses as well as in the case of gains, the basis shall be the March 1, 1913, value or the original cost, whichever is greater, where the property was acquired before March 1, 1913, in these words:

> "Sec. 204. (*b*) The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (A) the cost of such property * * *, or (B) the fair market value of such property as of March 1, 1913, whichever is greater. In determining the fair market value of stock in a corporation as of March 1, 1913, due regard shall be given to the fair market value of the assets of the corporation as of that date."

In the light of this experience, why should the Revenue Act of 1918 be construed to deny a deductible loss realized upon the sale of property during 1919 at a price below the March 1, 1913 value but above the original cost, contrary to the very plain and unambiguous language of the statute?

As stated, the basis for determining gains involves the determination of gross income. The rule established in Goodrich *vs.* Edwards, *supra,* has been adopted by Congress in the Revenue Acts of 1921 and 1924, either because of substantial justice or because of some question of constitutional doubt. In the case of losses, however, it has proved unjust or impracticable to limit the deduction for losses upon the sale of property acquired prior to March 1, 1913, to the original cost or the value on March 1, 1913, whichever is lower, and after three years experiment with this provision in the Revenue Act of 1921, Congress, upon the recommendation of the Treasury Department, in the Revenue Act of 1924 has definitely provided that the basis for determining losses sustained upon the sale of property

acquired prior to March 1, 1913, shall never be less than the March 1, 1913 value, nor less than the original cost if the original cost was in excess of such value.

If the plain language of the Revenue Act of 1918 is to be modified by construction, it is submitted that in view of the rule that a taxing statute is always to be construed most strongly against the Government, and in view of the experience of the Treasury Department under the Revenue Act of 1921, the rule for determining loss under the Revenue Act of 1924 would be a more just and appropriate construction than the rule for determining loss, as provided in the Revenue Act of 1921.

As stated in the beginning of this brief, however, the statutory language is so clear in the determination of deductions for losses, that no extraneous construction is required and the deductible loss should be based on the value on March 1, 1913, irrespective of the amount of original cost.

Respectfully submitted by

SANFORD ROBINSON,
Office and Post Office Address,
No. 26 Liberty Street,
New York, N. Y.
As *Amicus Curiæ*.

Dated: New York, N. Y., December 31, 1924.

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No. 527.

IN THE

Supreme Court of the United States,

OCTOBER TERM, 1924.

THE UNITED STATES,

Appellant,

v.

HARRIET ROGERS FLANNERY AND J. ROGERS FLANNERY,
EXECUTORS OF THE ESTATE OF JAMES J. FLANNERY, DECEASED,

Respondent.

BRIEF SUBMITTED WITH THE CONSENT OF THE COURT.

ARTHUR BALLANTINE,
BERNHARD KNOLLENBERG,
Amici Curiae.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1924

THE UNITED STATES, Appellant, v. HARRIET ROGERS FLANNERY and J. ROGERS FLANNERY, Executors of the Estate of James J. Flannery, Deceased, Respondent.	No. 527.

APPEAL FROM THE COURT OF CLAIMS

BRIEF SUBMITTED WITH THE CONSENT OF THE COURT BY ARTHUR A. BALLANTINE AND BERNHARD KNOLLENBERG, AMICI CURIAE.

Statement.

The issue in *Waialua Agricultural Company, Limited,* v. *The United States,* now pending in the United States Court of Claims, is the same as that in the present case and the two cases were

argued at the same time in the Court of Claims. The Government's demurrer to claimant's petition in the *Waialua* case was overruled on May 26, 1924, and proof of March 1, 1913, value is now being made in the Court of Claims. The issue in both cases is whether on the sale of property acquired before March 1, 1913, the proceeds are to be compared with the March 1, 1913 value or with the cost of the property as the underlying basis for computing the statutory gain or loss from the sale.

The Statute and Treasury Regulations.

The loss occurred in 1920 and its status for income tax purposes is governed by the provisions of the Revenue Act of 1918 (40 Stat. 1057 *et seq.*).

TITLE II.—INCOME TAX.

* * * * *

"Basis for determining Gain or Loss.

Sec. 202(*a*) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; or the in-

ventory value, if the inventory is made in accordance with section 203."

* * * * *

"Gross Income Defined.

Sec. 213. That for the purposes of this title (except as otherwise provided in section 233) the term 'gross income'—

(*a*) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such) of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

Sec. 214. (*a*) That in computing net income there shall be allowed as deductions:

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; but in the case of a nonresident alien individual only as to such transactions within the United States;

(6) Losses sustained during the taxable year of property not connected with the trade or business (but in the case of a nonresident alien individual only property within the United States) if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise;

"Tax on Corporations.

Sec. 230. (*a*) That, in lieu of the taxes imposed by section 10 of the Revenue Act of 1916, as amended by the Revenue Act of 1917, and by section 4 of the Revenue Act of 1917, there shall be levied, collected, and paid for each taxable year upon the net income of every corporation a tax at the following rates:

(1) For the calendar year 1918, 12 per centum of the amount of the net income in excess of the credits provided in section 236; and

(2) For each calendar year thereafter, 10 per centum of such excess amount."

* * * * *

"Net Income Defined.

Sec. 232. That in the case of a corporation subject to the tax imposed by section 230 the term 'net income' means the gross income as defined in section 233 less the deductions allowed by section 234, * * *."

"Gross Income Defined.

Sec. 233. (*a*) That in the case of a corporation subject to the tax imposed by section 230 the term 'gross income' means the gross income as defined in section 213, * * *."

"Deductions Allowed.

Sec. 234. (*a*) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * *

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;"

* * * * *

Section 301 providing for war profits and excess profits taxes has no material bearing on the question at issue and is, therefore, not quoted in this brief.

The original, contemporaneous Treasury Regulations.

Treasury Regulations 45, construing the 1918 Act, provided, as originally issued, that:

"Art. 1561—Basis for determining gain or loss from sale.—For the purpose of ascer-

taining the gain or loss from the sale or exchange of property the basis is (*a*) its fair market price or value as of March 1, 1913, if acquired prior thereto, or (*b*), if acquired on or after that date, its cost or its approved inventory value. * * *."

This Regulation was in force from 1919 until July 28, 1921.

The Treasury Department's change of position.

On July 28, 1921, the Commissioner of Internal Revenue issued *Treasury Decision 3206,* which amended Article 1561 of Regulations 45 to read as follows:

"Art. 1561. Basis for determining gain or loss from sale.—For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is the cost of such property, or if acquired on or after March 1, 1913, its cost or its approved inventory value. But * * * in the case of property acquired before March 1, 1913, when its fair market value as of that date is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor."

This is the Regulation now in force.

ARGUMENT.

I.

The language and intent of the 1918 Act fix the March 1, 1913, value of the stock as the basis on which to determine the deductible loss.

A. The Act plainly states that the basis for computing gain or loss on the sale of property acquired before March 1, 1913, shall be the March 1, 1913, value of the property.

The Government's position is, in effect, (1) that the meaning of the word "losses" as used in the sections of the Act (Secs. 214 and 234) providing for the deduction of losses, is to be sought, not in the statute itself, but in the common meaning of the word, and (2) that, as commonly used, "loss" means the difference between selling price and cost. Sec. 202(*a*) relating to the determination of gain or loss on the sale of property was not, the Government maintains, intended to fix March 1, 1913 value as the basis for determining statutory gain or loss, but was intended simply to restrict for tax purposes gains and losses determined in the first instance on the basis of cost.

Appellee's position is that the meaning of the word "losses", as used in the 1918 Act, is defined in Sec. 202(*a*) of the Act, and that the common meaning of "losses", if different from the statu-

tory definition, must, of necessity, yield to the statutory definition. (*Pirie* v. *Chicago Title & Trust Co.*, 182 U. S. 438, 442 (1901)).

Sec. 202(*a*) of the 1918 Act provides:

> "That for the purpose of ascertaining the gain derived or loss sustained from the sale * * * of property, * * * the basis shall be—
>
> (1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and
>
> (2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203."

Sec. 202 is one of the preliminary, definition sections and was plainly intended to define the meaning of the words "gains" and "losses", in the later, substantive provisions of the Act. This is recognized, except in the present connection, by the Treasury Department, which holds, for example, that statutory gain and loss on the sale of inventoried property is, as defined in Sec. 202(*a*) (2), the difference between the selling price and the inventory value, and not the difference between the selling price and cost. Furthermore, the provisions in Sec. 202(*a*) (2) that "cost" shall be the basis for determining gain or loss on the sale of one class of property, namely, property acquired *on or after* March 1, 1913,

clearly shows that Sec. 202(*a*) was intended to define the words "gains" and "losses", since, if the purpose of the Section was to limit gains and losses, defined by an extrinsic standard in all cases on the basis of cost, the insertion of this provision designating cost as the basis in only one class of cases, would have been superfluous and misleading.

In defining "gains" and 'losses" in Sec. 202(*a*), Congress clearly prescribed and intended March 1, 1913, value, and not cost, as the basis for computing statutory gains and losses on the sale of property acquired before March 1, 1913. This is established by the clear and controlling language of the statute and by the circumstances under which it was enacted.

At the time the 1918 Act was adopted, the Treasury Department held that, under the *1916* Act, statutory gain or loss on the sale of property acquired before March 1, 1913, must be computed on the basis of the March 1, 1913, value of the property without reference to its cost. This position was set forth in Article 90 of Treasury Regulations 33, Revised as follows:

> "In cases where securities or other assets, real, personal, or mixed, acquired prior to March 1, 1913, are disposed of during the year, the gain or loss thereon will be based upon the difference between the price at which disposed of and the fair market price

> or value of such assets as of March 1, 1913, or the difference between the price at which disposed of and the *cost* if acquired subsequent to that date."

The above language was embodied, without any material change, other than the insertion of a provision as to inventory value, in Sec. 202(*a*) of the 1918 Act.

It is difficult to suggest how, in brief compass, Congress could have more clearly expressed its intention to embody, in the 1918 Act, the Treasury Department's construction of the 1916 Act. Sec. 202(*a*) of the 1918 Act says that March 1, 1913, value shall be *"the basis", i. e.*, according to Webster, the "foundation; base; groundwork" for determining gain or loss on the sale of property acquired before March 1, 1913. The word "basis" of itself clearly shows that March 1, 1913, value was intended as the underlying basis for computing gain or loss and not as a limitation (as contended by the Government) on gain or loss computed on some other basis. Moreover, it is undisputed that cost was intended as *the basis—i. e.*, the underlying foundation,—for determining gain or loss on the sale of property acquired on or after March 1, 1913. Since the word "basis" in Sec. 202(*a*) indisputably means *basis,* as applied to the sale of property acquired on or after March 1, 1913, how can it reasonably be maintained that it means something

wholly different as applied to the sale of property acquired before March 1, 1913?

The intention to prescribe March 1, 1913, as the basis in the case of property acquired before March 1, 1913, and cost only in the case of property acquired on or after March 1, 1913, is shown not only by the unambiguous language of Sec. 202(*a*), but by the other provisions of the 1918 Act similar to, and therefore having a material bearing on the interpretation of, Sec. 202(*a*). These provisions are Sec. 202(*b*) relating to the determination of taxable profit on the exchange of securities, and Secs. 214(*a*) (10) and 234(*a*) (9) relating to the allowance for depletion.

Sec. 202(*b*), dealing with the *exchange of securities*, provides that:

> "When in the case of * * * reorganization, merger or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock or securities exchanged, * * * the amount of the excess in par or face value shall be treated as a gain to the extent that the fair market value of the new stock or securities is greater than the cost (or if acquired prior to March 1, 1913, the fair market value as of that date) of the stock or securities exchanged."

Sec. 234(*a*)(9) relating to *depletion* in the case of corporations, provides:

> "That in computing the net income of a corporation * * * there shall be allowed as deductions: * * *
>
> (9) In the case of mines, * * * and timber, a reasonable allowance for depletion * * * based upon cost * * * *Provided,* That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken *in lieu of cost up to that date.*" (Italics ours.)

Sec. 214(*a*)(10), relating to depletion in the case of individuals, contains precisely the same language as Sec. 234(*a*)(9).

These provisions, although varying slightly in wording and arrangement, all reflect the fundamental intention of Congress, in the 1918 Act, to substitute March 1, 1913 value for cost in matters relating to property acquired before March 1, 1913.

The language of the 1918 Act plainly provides that the statutory gain or loss on the sale of property acquired before March 1, 1913, shall be computed on the basis of the March 1, 1913, value of the property and not on the basis of cost.

B. Under decisions of the Supreme Court in force at the time the 1918 Act was adopted, the March 1, 1913, value of property owned by a taxpayer on that date constitutes the "capital value" of the property for income tax purposes, and loss determined on the basis of March 1, 1913 value is a real and not a "fictitious" loss.

The thought underlying the Government's contention that, despite the clear language to the contrary, Congress intended to provide in the 1918 Act that gain or loss on the sale of property acquired before March 1, 1913, shall be determined on the basis of cost, is set forth on pages 15, 16 and 22 of its brief in the *Waialua* case, argued in the Court of Claims along with the present case, as follows:

> "It is obvious that section 213 proposes to tax gains or profits derived from sales or dealings in property whether real or personal. It is likewise apparent that section 234 allows as a deduction losses sustained during the taxable year and not compensated for by insurance or otherwise.
>
> Congress clearly intended in the foregoing sections that gains and profits mean *actual* gains and profits and that the words 'losses sustained' mean *actual* losses. 'Paper' or fictitious gains or losses are not included, and are not intended to be included, as taxable or deductible, as the case may be."

* * * * *

> "* * * The date, March 1, 1913, was intended to be used *as a guide* in ascertaining *the amount* of gain derived or loss sustained, but original *cost* must *first* be taken into consideration, and if there is no actual gain on the entire transaction there is no taxable gain; and if there is no actual loss on the entire transaction there is no deductible loss." (Italics ours.)

It is not conceded that a loss, computed on the basis of the fair March 1, 1913 value of property owned on that date, is, as assumed by the Government, a "fictitious" loss. The test of the fictitiousness or artificialty of a loss is not whether it is based on cost or on some value other than cost, but whether there is some reasonable ground for the selection of the basis designated.

That a loss is no less "actual" because based upon fair market value as of a given date rather than upon cost, is clearly recognized in the case of property received by inheritance. If such property is sold by the heir at less than its value at the time of the inheritance, no one would question that the difference between the value of the property at the time of the inheritance and the selling price is an actual loss, although the cost of the property to the seller who sustained the loss, was nothing. The Treasury Department, even without specific authorization in the statute, has consistently held that the deductible loss on the sale

of property by the heir is the difference between the selling price and the value at the time of inheritance. (Article 1562 of Regulations 45; Art. 1563 of Reg. 62).

This principle is given effect in the provisions of the 1918 Act with respect to inventories. If a dealer in securities inventories securities at $12,000 which cost him $10,000, and during the next year sells these securities for $8,000, his deductible loss, under Sec. 202(*a*) of the 1918 Act, is $4,000, not $2,000. The Treasury Regulations give effect to this provision. (Article 1561 of Regulations 45.) The reason that the loss in this case is readily perceived to be an actual, not a fictitious loss, is the obvious appropriateness of taking the last inventory value, in place of cost, as the basis for computing the loss. The same is true as to March 1, 1913, value in relation to the determination of loss for income tax purposes. The Courts have consistently held that increase in value which accrued prior to March 1, 1913, the date when the Sixteenth Amendment became effective, must be regarded for income tax purposes as "capital value". Consequently, March 1, 1913, value is the most appropriate basis that could have been adopted for computing the deductible loss on the sale of property acquired before March 1, 1913, and the loss computed on this basis is not an artificial or fictitious loss.

This question as to the alleged "fictitiousness" of a loss based on March 1, 1913, value has been discussed at some length solely because of the Government's great emphasis on this point. The question has, at most, but a remote bearing on the construction of the statute, because, even if a loss exceeding the difference between selling price and cost were a "fictitious" loss, it clearly would not be within the province of the Court to substitute a loss, if any, determined on the basis of cost, for the loss as defined by the Act. Nothing is better settled than that where, as in the present case, the language of the Act is unambiguous and no constitutional difficulties are involved, this Court will not impute to Congress an intention other than that expressed in the language of the statute.

In *United States* v. *Standard Brewery,* 251 U. S. 210, 217, Mr. Justice Day, speaking for the unanimous Court, said:

> "Nothing is better settled than that in the construction of a law its meaning must first be sought in the language employed. If that be plain, it is the duty of the courts to enforce the law as written, provided it be within the constitutional authority of the legislative body which passed it. *Lake County* v. *Rollins,* 130 U. S. 662, 670, 671; *Bate Refrigerating Co.* v. *Sulzberger,* 157 U. S. 1, 33;

United States v. *Bank*, 234 U. S. 245, 258; *Caminetti* v. *United States*, 242 U. S. 470, 485."

This rule applies with peculiar force when, as in the present case, the provisions of the Act are not only clear, but, in the light of the circumstances prevailing at the time the statute was enacted, could not have been more reasonable and appropriate.

On May 20, 1918, a few months before the 1918 Act was drafted, the Supreme Court rendered its opinion in the case of *Doyle* v. *Mitchell Brothers Company*, 247 U. S. 179, which arose under the Corporation Excise (Income) Tax Law of 1909. The case involved the question of whether the taxable income on sales in the years 1909 to 1912 of the Company's timber lands acquired before January 1, 1909, should be computed on the basis of the *cost* of the timber lands or on the basis of their *value on January 1, 1909*,—the date as of which the Corporation Income Tax Law of 1909 took effect. Although the 1909 Act made no reference whatsoever to January 1, 1909, value, the Court nevertheless held that "income", as used in the Act, from the sale of property acquired before January 1, 1909, was the difference between selling price and January 1, 1909, value, rather than the difference between selling price and cost.

The Court's decision was based on the following reasoning:

> "In order to determine whether there has been gain or loss, and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the *capital value* that existed at the commencement of the period under consideration. * * *
>
> When the act took effect, plaintiff's timber lands, with whatever value they then possessed, were a part of its capital assets, and subsequent change of form by conversion into money did not change the essence. * * *
>
> It may be observed that it is a mere question of methods, not affecting the result, whether the amount necessary to be withdrawn *in order to preserve capital intact* should be deducted from gross receipts in the process of ascertaining gross income, or should be deducted from gross income in the form of a depreciation account in the process of determining net income. *In either case the object is to distinguish capital previously existing from income taxable under the act*". (pp. 185, 187, 188). (Italics ours.)

Two weeks later, on June 3, 1918, the Supreme Court affirmed the decision of the Circuit Court of Appeals in *Lynch* v. *Turrish*. In this case the Circuit Court of Appeals for the Eighth Circuit had held that no taxable income resulted from the receipt by Turrish of a liquidating dividend which

exceeded the cost but did not exceed the March 1, 1913, value of his stock in the liquidating corporation, on the ground that:

> "All * * * *the value of the stock of the plaintiff,* whether it was due to capital assets, or income, or gains, or profits, or all of these combined, *had arisen and accrued and had become their property before March 1, 1913.*" (p. 657). (Italics ours.)
>
> *Lynch, Collector* v. *Turrish,* 236 Fed. 653 (aff. 247 U. S. 221).

The Treasury Regulations issued under the 1916 Act already provided that gain or loss on the sale of property acquired before March 1, 1913, should be determined on the basis of March 1, 1913, value (*supra,* pp. 9-10; also Article 4, 101, 109, 111, 112, 116, 118, 119, 147, 157, 167 and 168 of Regulations 33, revised). As a result of the *Mitchell Bros. Co.* and *Turrish* decisions, this ruling was extended to the two previous income tax statutes—the 1909 and 1913 Acts—as well. *Treasury Decision 2740,* issued June 24, 1918.

It therefore clearly appeared, at the time the 1918 Act was adopted, that March 1, 1913 value was the most appropriate basis that could be designated for determining the statutory gain or loss on the sale of property acquired before March 1, 1913.

The explicit provision of Sec. 202(*a*) that in determining the gain or loss from the sale of property acquired before March 1, 1913, the basis shall be the value of the property as of that date, the immediate context of this provision, the other material sections of the Act, and the circumstances at the time the Act was adopted, all unite to show beyond the possibility of doubt that Congress intended, as it so plainly said, that under the 1918 Act the basis for determining gain or loss on the sale of property acquired before March 1, 1913, shall be the March 1, 1913, value of the property.

II.

The decisions in the Goodrich and Brewster cases construing the 1916 Act do not sustain the Government's contention that cost was the intended basis under the 1918 Act, since the provisions of the 1918 Act relating to the determination of gain or loss from the sale of property are vitally different from the corresponding provisions of the 1916 Act.

In the *Goodrich* and *Brewster* cases (255 U. S. 527 and 536 (May 28, 1921)), this Court held that in the 1916 Act the word "gains" as applied to the sale of property, irrespective of whether the property was acquired before or after March 1, 1913, meant the difference between sell-

ing price and cost. As shown hereinafter (*infra,* pp. 28-31) it does not follow that the Court would also have held, had the issue been presented, that the word "losses" as used in the 1916 Act meant the difference between selling price and cost. But even if the decisions in the *Goodrich* and *Brewster* cases implied that losses as well as gains must, under the 1916 Act, be computed on the basis of cost, the Government's contention that the words "gains" and "losses" must be given the same meaning in the 1918 Act, is unsound.

The Government appears to assume that the *Goodrich* and *Brewster* decisions hold or imply that the word "gain" shall be construed in income tax laws generally, including the 1918 Act, in the fixed sense of economic gain. Starting with this preconceived theory of the meaning of "gain", the Government disregards the vital differences in the language of the 1916 and 1918 Acts and the highly significant circumstances under which the 1918 Act was adopted (*supra,* pp. 17-19) and reads the 1918 Act not as it is, but as it presumably would have been, had Congress intended the gain and loss provisions in the 1918 Act to have the same meaning as those in the 1916 Act.

But the *Goodrich* and *Brewster* decisions do not sustain this theory. All that the Court was called upon to do and did do in the *Goodrich* and *Brewster* cases was to address itself to the meaning of

the word "gain" as used *in the 1916 Act.* The Court did not hold or imply that where, as in the 1918 Act, the language of the statute, and the circumstances under which the statute was enacted, clearly show that a different meaning was intended, it would not freely give effect to the expressed intention of Congress.

As pointed out by Mr. Justice Holmes, in *Towne* v. *Eisner:*

> "A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used" (245 U. S. 418, 425 (1918)).

The language of the 1916 Act, construed in the *Goodrich* and *Brewster* cases, reads as follows:

> "Sec. 2(*a*) That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, * * * from * * * sales, or dealings in property, * * *.
>
> * * * * *
>
> (*c*) For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first,

> nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived."

It will be observed that the first clause of subsection (*c*) is merely introductory and that the words "the fair market price or value of such property as of March first, nineteen hundred and thirteen" are the subject of the phrase "shall be the basis for determining the *amount* of such gain". March 1, 1913 value is here designated not as the underlying basis for determining whether the transaction resulted in a statutory "gain" or in a statutory "loss", but merely as the basis for determining "the amount" of taxable gain, thus implying that some other basis shall be used, in the first instance, in determining whether the transaction resulted in statutory gain or statutory loss.

This limited function of the provisions as to March 1, 1913 value in the 1916 Act is brought out even more clearly in the language of the section of the 1916 Act dealing with losses deductible by non-resident aliens:

> "Sec. 6. That in computing net income * * * there shall be allowed as deductions * * *
>
> Fourth. Losses actually sustained during the year, * * * Provided, That for the purpose of ascertaining *the amount* of such loss or losses * * * from * * *

> any kind of property acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining *the amount of such loss or losses* sustained." (Italics ours.)

In sharp contrast to the 1916 Act, the 1918 Act provides that March 1, 1913 value shall be the basis for *"ascertaining the gain derived or loss sustained"*. This, taken in conjunction with other significant changes, plainly negatives the implication of the 1916 Act that whether a statutory gain or loss has been realized shall first be determined on some basis other than March 1, 1913 value. It shows that, in the 1918 Act, March 1, 1913 value was intended as the basis for determining whether, for purposes of the Act, the transaction resulted in a gain, in a loss, or in an even break, as well as for determining the *amount* of the statutory gain or loss, if any.

A second significant difference in the two Acts is the ***difference in location*** of the provision as to March 1, 1913 value, in the respective Acts. The natural place to insert a limitation upon the amount of "gain" or "loss" which,—but for such limitation,—would be taxable or deductible, is, of course, immediately after the respective provisions for the taxation or deduction of such "gain" or "loss". In the provisions of the 1916 Act dealing

with the taxable gain of individuals—the provisions construed in the *Goodrich* and *Brewster* cases—the reference to March 1, 1913 value is found in precisely this juxtaposition, *i. e.,* it is in the same section *with* and *after* the provision for the taxation of "gains".

In the 1918 Act, however, as previously pointed out, the provisions as to the determination of gain or loss on the sale of property, including the provision as to March 1, 1913 value, appear in a section *wholly apart* from and *preceding* the sections providing for the taxation of "gains" and the deduction of "losses". Moreover, these provisions are found precisely where provisions intended to define the statutory meaning of "gains" and "losses" would naturally be inserted, namely, among the preliminary sections (Secs. 1 and 200 to 206 of the Act), devoted largely to defining and explaining the meaning of words and phrases used in subsequent portions of the Act. The incongruity of inserting a provision intended (according to the Government's contention) not as a definition but as a *limitation,* before the provision which it was intended to restrict, is evidently recognized by the Government. In setting forth the 1918 Act, the Government (pp. 2-3 of its Brief in this case) has interpolated Sec. 202(*a*) *immediately after* the provision in Sec. 214 for the deduction of losses.

A third material difference between the 1916 Act and the 1918 Act is the insertion in the later Act of a paragraph providing for "cost" as the basis for determining gain or loss on the sale of property acquired *on or after March 1, 1913*. The absence of any such provision in the 1916 Act enabled this Court to hold, without any inconsistency with the language of the statute, that, under that Act, cost was intended as the basis in all cases. The insertion, in the 1918 Act, of the provision that, in the case of a single designated class of property, gain and loss shall be determined on the basis of *cost*, clearly indicates that, under this Act, gain and loss on the sale of other property—including all property acquired before March 1, 1913, and inventoried property acquired on or after March 1, 1913—is to be determined on some different basis or bases.

A fourth difference between the two Acts is that the 1916 Act provides for the deduction of "losses *actually* sustained", whereas in the 1918 Act the word "actually" is dropped. If, as contended by the Government, *"actual"* losses are limited to losses measured by the difference between selling price and cost, the dropping of the word "actually" is of great significance as indicating that under the 1918 Act Congress did not intend to restrict deductible losses to losses measured by the difference between selling price and cost.

These various changes plainly show that Congress intended, in the 1918 Act, to amend the provisions of the 1916 Act relative to the determination of statutory gains and losses in order to bring these provisions into clear conformity with the Treasury Department's interpretation of the 1916 Act. It is a well-recognized principle of construction that where Congress re-enacts, in a later statute, the provisions of an earlier Act having an established administrative interpretation, it is to be presumed that Congress intended, in the later statute, to use the language of the earlier Act in the sense in which it was being interpreted under the earlier Act.

National Lead Company v. *United States,* 252 U. S. 140, 146-7 (1920);
Copper Queen Mining Company v. *Arizona Board,* 206 U. S. 474, 479 (1907);
United States v. *Falk,* 204 U. S. 143, 152 (1907).

The logic of this rule, of course, applies with extraordinary force in a case, like the present, where Congress has, in the later Act, *amended the language of the earlier Act to conform* to the construction placed upon the earlier Act by the Executive.

The Government's contention that the *Goodrich* and *Brewster* decisions are controlling in the pres-

ent case is based on the assumption that the provisions of the 1918 Act with respect to the determination of statutory gain and loss are substantially the same as those of the 1916 Act, whereas, both as to language and location, the provisions of the 1918 Act are vitally different from those of the 1916 Act and unmistakably show that in the later Act Congress intended and prescribed March 1, 1913 value as the basis for determining gain or loss on the sale of property acquired before March 1, 1913.

III.

Any doubt as to the constitutionality of including in taxable income an amount in excess of the gain computed on the basis of cost does not apply to the allowance of a deductible loss in excess of the loss computed on the basis of cost.

As the basis for the discussion under the preceding heading, it was assumed that, as contended by the Government, the Court would construe the provisions of the 1916 Act as to deductible loss in the same way that the provisions as to taxable gain were construed in the *Brewster* and *Goodrich* cases. But the validity of this assumption is not admitted, since constitutional considerations which must have influenced the de-

cision as to *gains*, do not apply to the construction of the provisions as to *losses*.

In the appellant's brief in the *Goodrich* case, (p. 63 of the brief), the constitutional question with respect to the taxation of gain was set forth as follows:

> "It is submitted that it is reasonably manifest that a construction of the Income Tax Law of 1916 which would practically result in levying a tax upon and measured by what is essentially diminished or reduced capital would be unconstitutional as being in substance and effect a direct tax payable solely in respect of capital or out of the proceeds of capital. At any rate, there are certainly 'grave doubts upon that score.' In such a case the rule in this court is to avoid a conclusion which might render a statute even of doubtful constitutionality (*United States* v. *Standard Brewery*, 251 U. S. 210, 220; *United States* v. *Jin Fuey Moy*, 241 U. S. 394, 401; *United States* v. *Delaware & Hudson Co.*, 213 U. S. 366), and to adopt a construction which will avoid such doubts, if reasonably permissible. Moreover, equally well-settled is the rule that any doubt as to the intent of a tax law will be resolved in favor of the taxpayer. *Gould* v. *Gould*, 245 U. S. 151; *Eidman* v. *Martinez*, 184 U. S. 578, 583-590."

The Solicitor General, not only made no reply to this argument, but (abandoning the Treasury Department's construction of the 1916 Act, which

the Government had maintained in the lower court), expressly conceded in his brief in the *Goodrich* case that

> "If this construction" [that March 1, 1913, value, in place of cost, was intended as the basis for determining taxable gain on the sale of property acquired before March 1, 1913] "of the law is correct, a *serious constitutional question arises.* * * * The contention is that, *under the commissioner's construction* of the law, *something is taxed which is not,* in fact, *income and which Congress was therefore without the power to tax* except by apportionment." (Italics ours.)

Since it is an established rule of construction that a statute will be construed, if reasonably possible, to avoid questions of possible unconstitutionality, (*United States* v. *Delaware & Hudson Company,* 213 U. S. 366, 407-8 (1909)), the decision in the *Goodrich* case was doubtless influenced by the Solicitor General's concession on the constitutional point. The decision might well, therefore, have been different had the issue been one as to losses, as to which no constitutional question exists.

That Congress may allow such deductions as it sees fit, in defining net taxable income, (subject, of course, to the ordinary constitutional restrictions as to uniformity, etc.), has been accepted as settled ever since the decision in *Brushaber* v. *Union Pacific Railway Company,* 240 U. S. 1

(1916), in which the Supreme Court summarily dismissed the contention that the 1913 Act was unconstitutional because providing for certain non-economic exemptions and deductions. There has never been any question, for example, of the validity of the provisions of the 1918 Act permitting deductions for "losses" by fire or other casualty of property held for personal use, "taxes" on residential or other property from which no income is derived or expected, "interest" on non-business indebtedness, and depletion based on March 1, 1913 value in excess of cost. *A fortiori* the allowance of a deductible loss based on March 1, 1913 value, such value having been held to be "capital value" for income tax purposes, is open to no possible question, (*the Mitchell Bros. Co.* and *Turrish* decisions, pp. 17-19, *supra*).

Constitutional necessity, if any, of permitting taxpayers to use cost, if more than March 1, 1913 value, as the basis for computing taxable gain, would not sustain the denial to taxpayers of a right, conferred by statute, of using March 1, 1913 value, in place of cost, as the basis for computing losses. As said by this Court in *Supervisors* v. *Stanley*, 105 U. S. 305, 312 (1881):

> "in a statute which contains invalid or unconstitutional provisions, that which is unaffected by these provisions, or which can stand without them, must remain. If the valid and invalid are capable of separation, only the latter are to be disregarded;"

IV.

The provisions of the 1921 and 1924 Acts relative to the determination of statutory gain and loss furnish additional evidence that, in the 1918 Act, March 1, 1913 value, in lieu of cost, was the prescribed and intended basis for determining gain or loss on the sale of property acquired before March 1, 1913.

The 1921 Act:

In the 1921 Act Congress provided that whether a statutory gain or loss had been realized should be determined in the first instance on the basis of cost. March 1, 1913, value was only to be referred to as a means of determining what part of the gain or loss determined on the basis of cost should be included in computing net taxable income. The Government contends this same method was provided for in the 1918 Act. Nothing, however, could more clearly show the unsoundness of this position than a comparative reading of the corresponding provisions of the two Acts set forth, in parallel columns, below.

1918 Act.	*1921 Act.*
"Sec. 202.(*a*) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal or mixed, *the basis shall be*—	"Sec. 202.(*a*) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913,

1918 Act.

(1) *In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date;* and

(2) In the case of property acquired on or after that date, the *cost* thereof; or the inventory value, if the inventory is made in accordance with section 203. (Italics ours.)

1921 Act.

shall be the cost of such property; except that—

(1) In the case of such property, which should be included in the inventory, the basis shall be the last inventory value thereof;

* * * * *

(*b*) *The basis* for ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired *before* March 1, 1913, *shall be the same as that provided by subdivision* (*a*) [*i. e. "cost"*]; but—

(1) If its fair market price or value as of March 1, 1913, is in excess of such basis, the gain to be included in the gross income shall be the excess of the amount realized therefor over such fair market price or value;

(2) If its fair market price or value as of March 1, 1913, is lower than such basis, the deductible loss is the excess of the fair market price or value as of March 1, 1913, over the amount realized therefor; and

(3) If the amount realized therefor is more than such basis but not more than its fair market price or value as of March 1, 1913, or less than such basis but not less than such fair market price or value, no gain shall be included in and no loss deducted from the gross income." (Italics ours.)

The 1918 Act provides: (1) that the basis for ascertaining the gain or loss on the sale of property acquired before March 1, 1913, shall be the fair market value of such property as of that date; and (2) that the basis for determining the gain or loss on the sale of property acquired on or after March 1, 1913, shall be cost. The 1921 Act, on the contrary, specifically provides that *in both cases* the basis shall be *"cost"*.

This striking difference in language results from and expresses a difference in the conception of the function of March 1, 1913, value in the two Acts. When the 1918 Act was adopted, the approved basis for determining gain or loss on the sale of property acquired before March 1, 1913, was the March 1, 1913 value of the property. (*supra*, pp. 17-19). The Supreme Court in the *Mitchell Bros. Co.* and *Turrish* decisions had approved of this basis in principle and the Treasury Department consistently applied this basis under the 1916 Act.

At the time the 1921 Act was passed, the circumstances had vitally changed. The Solicitor General, in the *Brewster* case, had repudiated the Treasury Department's construction of the 1916 Act, partly on the ground that it raised "a serious constitutional question", and this Court, shortly before the 1921 Act was drafted, held in the *Brewster* case that the intended basis under the 1916 Act was cost. (pp. 20, 30, *supra*). It

was doubtless this change in circumstances that led Congress to amend the provisions of the 1918 Act and to adopt, in the 1921 Act, the basis of cost rather than that of March 1, 1913, value.

If the amendments in the 1921 Act had been intended as a legislative interpretation of the 1918 Act Congress would unquestionably have said so, as it did in Section 1331 of the 1921 Act dealing with consolidated returns, which provides that:

> "The provisions of this Section are declaratory of the provisions of Title II of the Revenue Act of 1917."

The plain inference is that the striking and discriminating changes in the 1921 Act were made for the purpose of establishing a different basis under the 1921 Act than the one provided for in the 1918 Act.

> *Harriman* v. *Interstate Commerce Commission,* 211 U. S. 407, 422 (1908); *United States* v. *Field,* 255 U. S. 257, 265 (1921).

That Congress did not regard the basis of March 1, 1913 value as intrinsically inappropriate, is clearly shown by the fact that, even in the 1921 Act, Congress designated March 1, 1913 value as the basis on which to compute the statutory deductions for depletion, depreciation and loss by fire or other casualty, of property acquired before March 1, 1913. (Sec. 214(*a*) of the 1921 Act).

Analysis of the 1921 Act sustains and reenforces the position that, in the 1918 Act, Congress prescribed and intended March 1, 1913 value as the basis for determining statutory gain or loss on the sale of property acquired before March 1, 1913.

The 1924 Act:

The provisions of the 1924 Act with respect to the determination of gain or loss on the sale of property are as follows:

> Sec. 204(*a*): "The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—
>
> (1) If the property should have been included in the last inventory, the basis shall be the last inventory value thereof;
>
> * * * * *
>
> (*b*) The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (A) the cost of such property * * * or (B) the fair market value of such property as of March 1, 1913, whichever is greater."
>
> Sec. 214(*a*) "In computing net income there shall be allowed as deductions; * * *
>
> (4) Losses sustained during the taxable year * * *;"

The provisions of the 1924 Act show that it is necessary, in computing taxable gain or deductible loss under that Act, to look to the language of the statute and not to what may be deemed to be the familiar meaning of the words "gains" and "losses". If the Government's contention in the present case were followed, the word "losses", as used in Sec. 214(*a*), would be held to mean the difference between selling price and cost, while the provisions of Sec. 204(*b*) as to March 1, 1913 value would be treated as a mere limitation on the loss, if any, based on cost. The provisions of Sec. 204(*b*) giving to the taxpayer the option of using March 1, 1913 value or cost whichever is greater, would thus be nullified. In construing the 1924 Act, the Treasury Department rejects any such unwarranted distortion of the Act. The Department recognizes that the meaning of the word "losses", as used in Sec. 214, is not to be sought in some extrinsic guide, but is to be accepted and applied as defined in the Act. (Article 1591 of the 1924 Regulations (Regulations 65)).

The language of the 1918 Act shows with equal clearness that the provisions of Sec. 202(*a*) of that Act were intended to define the meaning of the word "losses" as used in that Act.

V.

The respondent's construction of the 1918 Act is sustained by the decisions of the United States Circuit Court of Appeals and of the Court of Claims.

The question at issue in the present case has been passed upon in several decisions.

In *Ludington* v. *McCaughn,* the Circuit Court of Appeals for the Third Circuit, in a clear and comprehensive opinion written by Judge Woolley, sustained the deduction under the 1918 Act of a loss, based on March 1, 1913 value, which exceeded the loss computed on the basis of cost. (Corporation Trust Company 1924 Income Tax Service, p. 892; October 1, 1924.) This decision reversed the judgment of the United States District Court for the Western District of Pennsylvania in the *Ludington* case (290 Fed. 604 (1923)).

The only decision, other than that of the District Court in the *Ludington* case, holding that the deductible loss is limited to the difference between selling price and cost, is a decision, without opinion, by the New York Supreme Court, Appellate Division, Third Department, in *Bush* v. *Law,* 201 N. Y. Supp. 513 (1923), construing Sec.

353 of the New York Income Tax Law of 1919, which is substantially the same as Sec. 202(*a*) of the Federal Revenue Act of 1918. A strong dissenting opinion was written in the *Bush* case by Judge Hasbrouck.

In *Vance* v. *McLaughlin,* the United States District Court for the District of California held that March 1, 1913 value is the statutory basis, under the 1918 Act, for computing the deductible loss on the sale of property acquired before March 1, 1913, (Corporation Trust Company 1924 Income Tax Service, p. 829).

The Court of Claims, in its opinion in the present case, favorable to the claimant, fully considered and met the arguments relied on by the Government in this appeal. The Court said in part:

> "Section 214, under the heading 'Deductions allowed', provides that in computing net income there shall be allowed 'as deductions' a number of items listed as * * * (4) Losses sustained during the taxable year * * *.
>
> "The Act anticipated the question as to what are 'losses' that are thus authorized to be deducted because" (in Sec. 202(*a*)) "it prescribes a 'basis for determining gain or loss,' * * *.
>
> "It is a primary and general rule of statutory construction that the intent of the law-

maker is to be found in the language that he has used. * * *

"The present case has to do with losses sustained, and the loss which Congress authorized to be deducted was a loss measured by the difference between the price stated at one time and another time. Manifestly the meaning of losses sustained as the words appear in section 214 is not to be determined independently of other parts of the Act. * * * Congress could have omitted the basis for determining loss, but it did not do that, and inserted section 202 instead. Congress * * * carefully distinguished between 'property acquired before March 1, 1913' and property acquired on or after that date. As to the former, the price or value as of March 1, 1913, governs, and as to the latter, 'the cost thereof' governs. The first of these distinctions is wiped out if the cost prior to March 1 be required, and the second clause is useless if the original cost of the property must in every case be used in ascertaining the deductible loss."

This decision was followed by the Court of Claims in the *Waialua* case (Corporation Trust Company 1924, Income Tax Service, p. 837 (May 26, 1924)).

Conclusion.

For the reasons set forth in this brief and in the decision of the Court below, it is clear that the March 1, 1913 value was the prescribed and intended basis, under the 1918 Act, for determining the deductible loss on the sale of property acquired before March 1, 1913, and that the judgment of the Court below should be affirmed.

Respectfully submitted,

ARTHUR A. BALLANTINE,
BERNHARD KNOLLENBERG,
Amici Curiæ.